Backgrounder: Trade-Based Money Laundering in Canada
September 2019

Definition: Proceeds of crime fuel transnational criminal activity. Most illicit financial flows believed to cycle to and through Canada originate through the commission of so-called "predicate" criminal offences, particularly narcotics trafficking, but also a range of other offences including human smuggling and trafficking, contraband smuggling and trafficking, etc. These flows need to be layered and integrated into legitimate economies in jurisdictions where they can be accessed and used by criminal actors.

According to the Financial Action Task Force (FATF), the international body responsible for establishing global anti-money laundering and anti-terrorist financing (AML/ATF) norms and best practices, there are three main methods to disguise illicit proceeds and integrate them into the formal economy:
- Via the financial system;
- Through the physical movement of cash and monetary instruments; and finally,
- Through the physical movement of goods through the trade system.

The risk of money laundering through financial institutions and bulk cash smuggling is well known, and corresponding AML/ATF controls are robust. However, abuse of the international trade system has received relatively little attention by most national governments and awareness of trade-based threats is generally limited. The process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins is thus known as "trade-based money laundering" (TBML).

Threat Environment: Most TBML occurs through the use of commercial trade fraud techniques, primarily through the mis-description of the price, quantity or quality of goods on documents presented to Customs Services on the importation or exportation of goods from a national jurisdiction.

There are a range of TBML methods, however, a typical scheme will involve the use of proceeds of crime by complicit import/export companies to purchase goods destined to or from Canada. Goods will be fraudulently over- or under-valued (weights and goods descriptions can also be manipulated) on customs documents in order to inflate or deflate their value, depending on the direction of the intended flow of proceeds. The import or export of goods creates the necessary pretext for criminal syndicates to wire funds to "pay" for said goods at source or destination. The sale of said goods thus completes the money laundering cycle. Circumvention of customs regulations is thus the basis for most TBML schemes.

TBML is easily concealed in enormous volumes of global trade, leading some experts to proclaim it as the largest money laundering method in the world, but also the least known and understood[i]. By some estimates, the trade fraud that underlies TBML accounts for over 80% of illicit financial flows from developing nations, and may cost the global economy as much as 1 to 7 percent of annual Gross Domestic Product (GDP) each year[ii].

Canadian Context: CBSA lead development work and partner intelligence reveals that suspected TBML activity is occurring on a daily basis in Canada,

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true extent of TBML is believed to be higher than these figures suggest, owing to the limited resources dedicated to TBML in Canada, leading to significant gaps in available threat knowledge.

R1 highly liquid, high-demand goods and/or those with wide pricing margins, such as garments, textiles, vehicles and parts, electronics, scrap metals, forestry products and agri-foods appear to be favoured for TBML R1 Cartel drug trafficking accounts for much of the proceeds being laundered. Most of the funds related to these schemes enter Canada from the United States, China, Hong Kong, and the United Arab Emirates (UAE) for goods shipments to a wide variety of third countries.

There are also emerging indicators of a series of thriving informal value transfer networks operating across Canada that are facilitating illicit financial flows to and from Canada and a variety of international jurisdictions including China, Hong Kong and the UAE, possibly linked to proceeds of crime, capital flight from China and Iranian sanctions evasion. It is unclear of the degree to which the money remitters operating these informal networks are aware of the source of the funds they are transmitting through the international movement of goods.

> **Professional Money Launderers (PMLs):** A significant amount of laundering continues to be carried out by low level currency smuggling "mules" who are paid or coerced to physically move cash between jurisdictions. However, logistical difficulties plus the risk of theft or interdiction have led many sophisticated criminal networks to adopt less risk-prone and more efficient methods of money laundering, including the increasing use of PMLs in order to reduce their exposure to law enforcementiii.

> PMLs are not involved in the generation of the proceeds of crime. Instead, they charge commissions to launder criminal proceeds. Many PMLs hold professional designations or own businesses conducive to laundering, including lawyers, accountants and trade chain professionals.

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TBML is attractive to these groups because goods purchased with proceeds of crime can be easily transmitted across borders and sold in local currencies conducive to funding the criminal enterprise – a TBML technique known as a Black Market Peso Exchange.

The identities of the international and domestic money controllers/remitters who broker laundering deals between organized crime groups and PMLs across borders remains a key GOC intelligence gap, although indicators of their involvement have been identified in several ongoing CBSA files.

Risk Environment: The risk of TBML in Canada is very high. While the full scope and scale of TBML in Canada remains a gap, a sufficient body of intelligence exists to indicate that Canada is being routinely exploited for its relatively weak anti-money laundering controls, including limited awareness of laundering through the international trade in goods in both the public and private sectors.

Canada likely remains an attractive distribution link in the international flow of narcotics proceeds back to producers, rather than as a key source or destination for the proceeds themselves through TBML techniques. However, there are emerging indications that the funds tied to foreign capital flight and possible international sanctions evasion may be destined to remain within Canadian financial institutions. The mis-description of customs and trade chain documents remains the primary assessed method for faciliting this laundering activity.

Detriment to Canada:

1. **National Security:** TBML fuels global crime and terrorism, by providing a relatively risk-free mechanism to repatriate narcotics, corruption and terrorist financing proceeds, and to evade international sanctions.
2. **Reputation:** The continued flow of illicit finances to and through Canada via trade could negatively impact and Canada's reputation and further entrench the perception of Canada being "soft" on money laundering activity.
3. **Economic Security:** TBML has the potential to weaken the integrity of Canadian financial institutions. In addition, the customs mis-description techniques underlying TBML have the ability to undermine legitimate economic competition and distort legitimate trade data used by the government to affect macro-economic policy decision.
4. **Revenue:** TBML has the potential to deprive countries of duty and tax revenues that may otherwise be collected on goods that draw rates of duty or those with tariff rate quotas used to sustain supply management programs.

Policy Context:

Money laundering is a growing global strategic risk. Canada received a "failing grade" by the FATF during its last evaluation of Canada's AML/ATF Regime in 2016 for a number of control gaps leading to a perceived "soft stance" on money laundering, and was placed into an enhanced follow-up process requiring annual progress updates to the FATF regarding these concerns. Key FATF criticisms centered

around lack of transparent beneficial ownership requirements for corporations, lack of participation by the legal profession in AML/ATF Regime suspicious transaction reporting, and, notably, for the limited use of financial intelligence and a low corresponding volume of dedicated proceeds of crime prosecutions.

Moreover, many of these concerns were further entrenched the 2018 *Parliamentary Review of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act*, a statutory review occurring every 5 years. The Parliamentary Review specifically identified trade-based money laundering as a top money laundering risk, and identified possible mitigation methods, including the use of U.S.-style Geographic Targeting Orders to

The FATF's posture towards Canada has been echoed by key international partners. For example, the United States Department of State's 2017 International Narcotics Control Strategy Report lists Canada as a "major money laundering country", alongside Argentina, Brazil, the Cayman Islands, China, Columbia, Cyprus, the Dominican Republic, Iran, Mexico, and Macau.

These findings have coincided with a dramatic increase in media reporting on so-called "snow-washing" in Canada, i.e., the ease with which gaps identified by the FATF have been exploited in order to facilitate money laundering in the real-estate and casino sectors, as well as through the trade in goods.

Policy Initiatives: Successfully combating TBML requires enhanced collaboration, information sharing and new approaches with both domestic and international partners across the law enforcement, tax, and financial intelligence domains. The Government of Canada's response to the recommendations in the *Parliamentary Review of the Proceeds of Crime (Money Laundering) and Terrorist Financing* (2018), led to the creation of over 200 proposals from across the 11 members of the AML/ATF Regime, including six from the CBSA. These proposals were eventually narrowed through interdepartmental consultations to 21 initiatives that were subsequently put forward for funding consideration. Two of these initiatives, which directly pertain to combatting TBML, were the subject of Budget 2019 funding announcements, as follows.

> **GOC AML Action, Coordination and Enforcement (ACE) Team:** Public Safety Canada will implement an anti-money laundering intelligence fusion team commencing in FY2020-21. The team will co-locate dedicated experts from the CBSA, CRA, FINTRAC, Public Prosecution Service, PPSC/Seized Property Management and Forensic Accounting groups, and the RCMP to strengthen inter-agency coordination and cooperation and identify and address significant money laundering and financial crime threats. The focus of the ACE Team will likely centre around TBML, as well as casino and real estate based money laundering.

> **CBSA Centre of Expertise:** The CBSA is planning to significantly enhance the its capacity to identify, interdict, and prosecute the complex trade fraud that underlies TBML in partnership with the RCMP/ACE Team. Commencing in April 2020-21, the CBSA will establish a multi-disciplinary team comprised of intelligence analysts, trade specialists, criminal investigators, and additional support positions (auditors, data analysts, forensics specialists) will better

position the Agency to identify and investigate anomalous trade transactions indicative of both fraud and TBML, fill in knowledge gaps on PML entities and modus operandi, and prompt enhanced enforcement action.

Legislative Authorities / Mandates: There is no offence under Canadian law called "trade-based money laundering". Rather, TBML involves both proceeds of crime offences, a.k.a. "money laundering", under subsection 462.31(1) of the *Criminal Code* that are perpetrated through trade fraud schemes. In most cases, the trade fraud aspect of TBML involves offences under subsection 160 (1) of the *Customs Act* related to the requirements for "true, accurate and complete" reporting of imports and exports [further to subsections 7.1 and 95(3)].

Under *Criminal Code* proceeds of crime provisions, the Royal Canadian Mounted Police must be able to link money laundering to an underlying designated offence in order to secure successful charges. Establishing this link may be feasible in some instances, for example, when drug trafficking networks launder their own proceeds.

However, the increasing use of Professional Money Laundering networks who are not involved in underlying offences significantly reduces the ability of the RCMP to pursue money laundering cases. Offences under subsection 160(1) of the Customs Act are hybrid, thus meeting the definition of "designated offence" under subsection 462.3(1) of the Criminal Code and allow for the RCMP to pursue TBML when targets are PMLs, or when other underlying offences are otherwise not immediately apparent.

> **Link to CRA:** TBML schemes may also involve wilful contraventions of the *Income Tax Act.* Fraudulent goods declarations often have bearing on the declared income of the front and shell import/export companies favoured in many TBML schemes. Similarly, income tax offences in the form of export tax credit fraud may also be vertically integrated into TBML schemes. As such, it remains the intention of the Government of Canada to increasingly leverage *Customs Act* and *Income Tax Act* offences for the purposes of combatting TBML, primarily through the pursuit of Joint Force Operations and, over time, through the forthcoming policy initiatives outlined above.

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[ii] Trade Based Money Laundering: The Next Frontier in International Money Laundering Enforcement. John A. Cassara. Wiley. 2015

[ii] Derived from a range of estimates pertaining to either US or broader global estimates for all forms of money laundering (i.e. UNODC, IMF), of which TBML is assessed to be a significant part (see, for example Goods Gone Bad: Addressing Money-Laundering Risk in the Trade Finance System, PWC, January 2015)

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